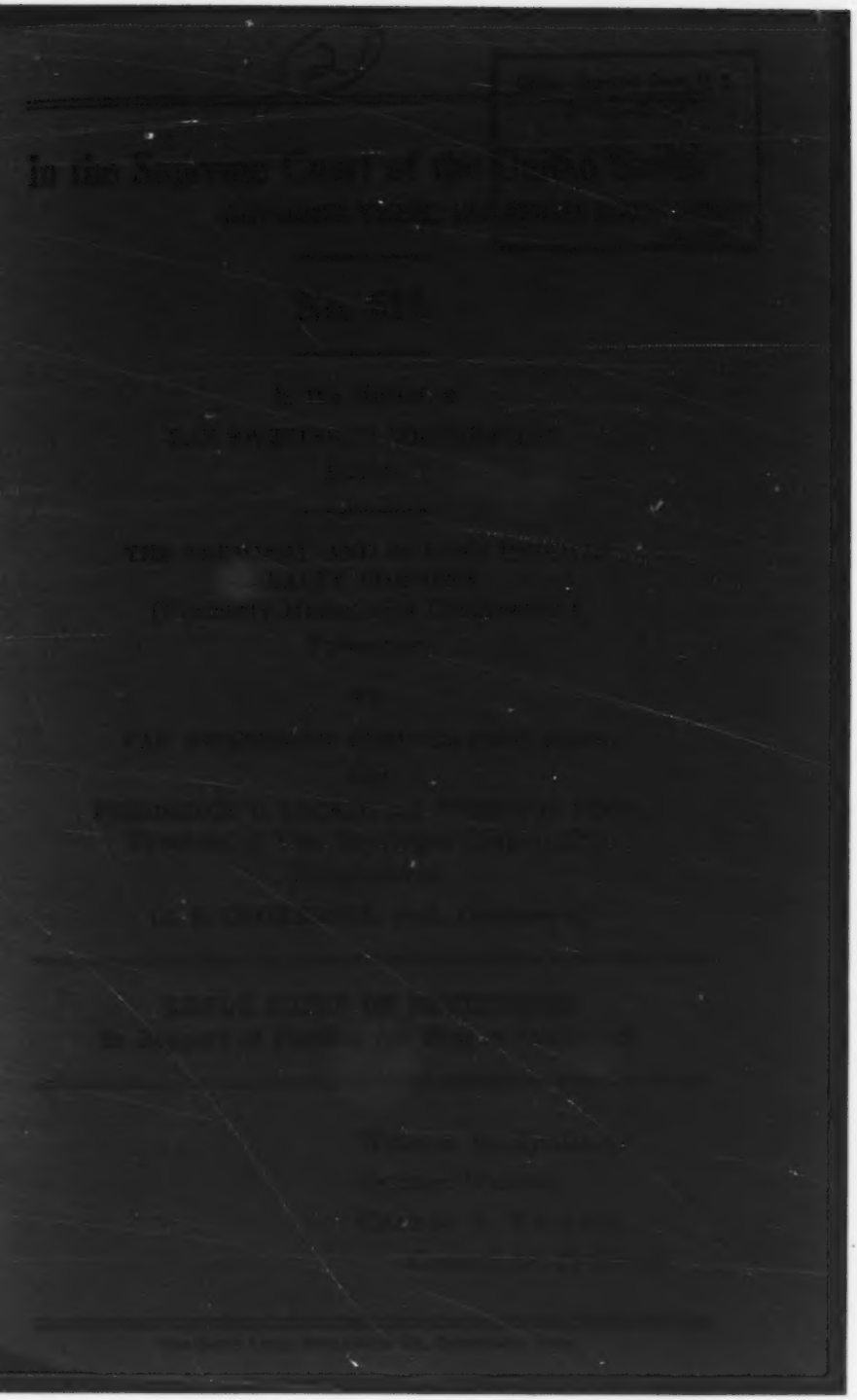
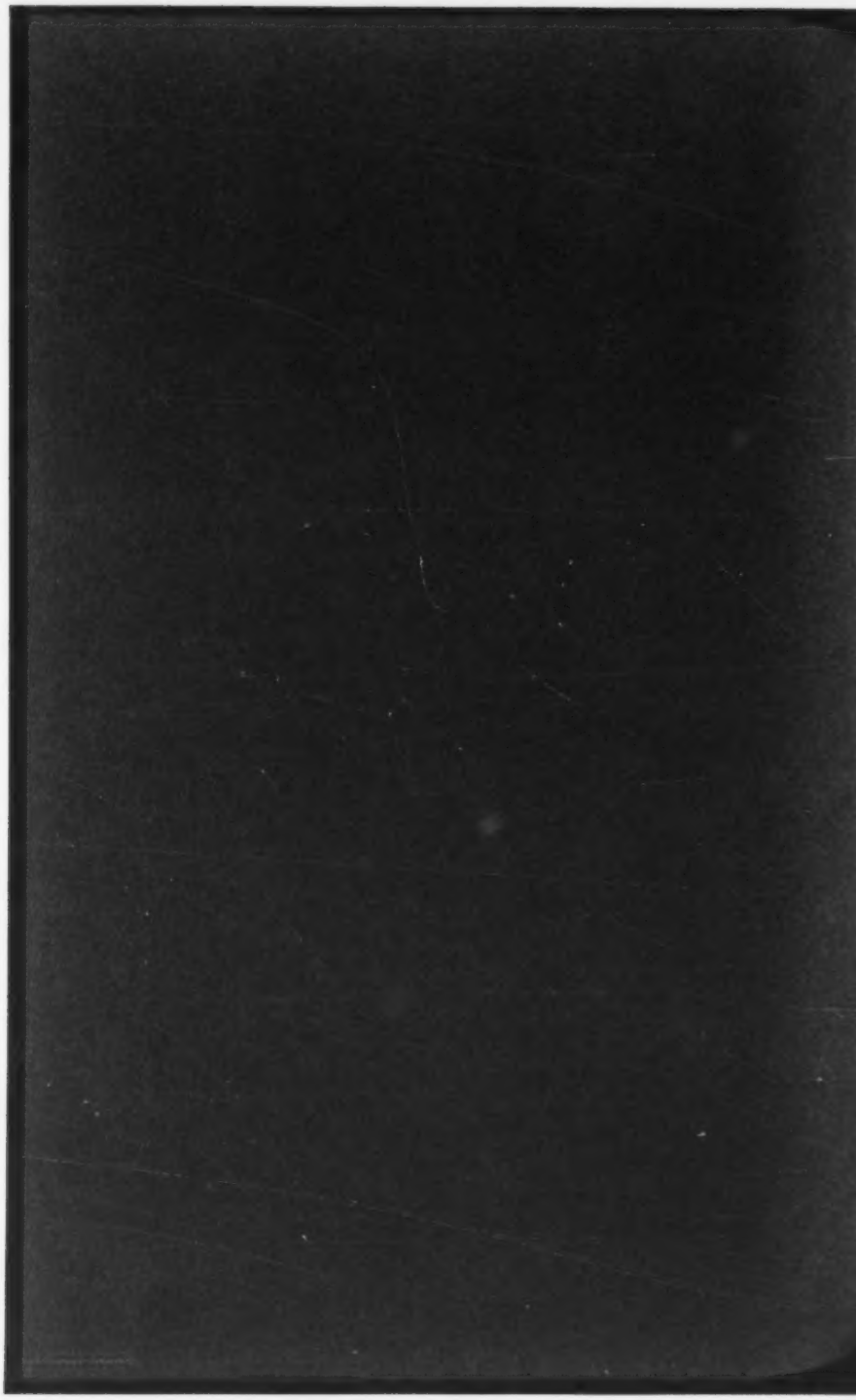




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In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. 613.

In the Matter of

VAN SWERINGEN CORPORATION,

Debtor.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY
(Formerly Midamerica Corporation),

Petitioner,

vs.

VAN SWERINGEN CORPORATION, *Debtor,*
and

FREDERICK L. LECKIE and JOSEPH G. FOGG,
Trustees of Van Sweringen Corporation,

Respondents.

(A. B. GOCHENOUR, *et al., Intervenors.*)

REPLY BRIEF OF PETITIONER
In Support of Petition for Writ of Certiorari.

Midamerica believes that its reasons for asking certiorari remain unshaken by the briefs in opposition in this case, No. 613, and in the companion cases, Nos. 612 (The Van Sweringen Company) and 614 (The Cleveland Terminals Building Company), and Midamerica is filing no separate reply briefs in those cases. However, in the case of Van Sweringen Corporation (hereinafter sometimes called the "Debtor"), Midamerica desires to file this reply, limited (a) to showing that, under two recent decisions of this

Court, the question here is one of serious consequence both in the law of fiduciaries and in the uniform administration of the Bankruptcy Act, (b) to demonstrating that—despite the Debtor's brief—uniform administration is here impaired by a definite divergence among the circuits, and (c) to answering an unwarranted charge by the Debtor concerning Midamerica's failure to cite certain authorities below.

1. **The Issue Here Concerns a Question of Importance Both in the Law of Fiduciaries and in the Uniform Administration and Interpretation of the Bankruptcy Act. Woods, Court Trustee, v. City National Bank and Trust Co. of Chicago, et al., 312 U. S. 262 (1941), American United Mutual Life Insurance Co. v. City of Avon Park, Florida, 311 U. S. 138 (1940).**

Neither the Debtor's brief nor any of the other briefs in opposition make any effective answer to Midamerica's contention, set forth in subsections (i-iii) on pp. 15-19 of all three of Midamerica's briefs, that (i) the volume of litigation over this type of question in bankruptcy proceedings is large and is increasing, and that, as formerly in the case of landlords' claims, there is need of authoritative clarification in this field; (ii) the decision here, because of the fiduciary questions of law involved, bears directly on § 212 and § 202 of the Bankruptcy Act, 11 U. S. C. A., § 612 and § 602, relating respectively to breach of trust in the acquisition of claims by various types of fiduciaries and to the "scrutiny clause" affecting assignment of landlords' claims; and (iii) the issue here presented is one of serious consequence not only as a matter of fiduciary law, but also in the uniform administration of the Bankruptcy Act.

(a) Debtor's Brief in Opposition. The Debtor states, without discussion, that the granting of a writ will not aid in administering the Bankruptcy Act because this case

does not arise under either § 212 or § 202, but merely involves "long established principles of equity." (Debtor's brief, p. 15.) Of course, the case does not arise under either of these sections: it arises under § 196, 11 U. S. C. A., § 596, providing for the filing and allowance of claims. But the Debtor's suggestion that, because the case merely involves "principles of equity," it will not influence the interpretation and application of important provisions of the Bankruptcy Act which are in this instance essentially a codification of doctrines of equity, will not stand analysis.

The Bankruptcy Act grants the Federal courts exclusive jurisdiction to "allow claims" and to "disallow claims," Section 2a(2), 11 U. S. C. A. § 11a(2); and this general grant was specifically repeated in Section 196 of Chapter X and in Subsection (c)(6) of former Section 77B, both relating to the filing and allowance of claims. Obviously, the duty to allow and disallow claims means the duty to "allow *proper* claims" and to "disallow *improper* claims." If the Act so read, the case would be the same as *Woods, Court Trustee, v. City National Bank and Trust Co. of Chicago, et al.*, 312 U. S. 262 (1941), where this Court was called upon, in a Chapter X proceeding, to decide the correct interpretation of Section 242 of Chapter X, 11 U. S. C. A., § 642, allowing reimbursement for "proper costs and expenses incurred in connection with the administration" of the estate. The Court there granted certiorari "in view of the importance in reorganization proceedings of the power of the District Court over such allowances" (p. 264 of 312 U. S.) and would no doubt have granted review even if the Act had allowed reimbursements simply for "costs and expenses." Although the answer depended ultimately upon the law of fiduciaries and doctrines of equity, there can be no question that the case was one of importance in the administration of the Bankruptcy Act.

Similarly in *American United Mutual Life Insurance Co. v. City of Avon Park, Florida*, 311 U. S. 138 (1940), a

case arising under Chapter IX of the Act, this Court granted certiorari—"in view of the importance of the problems in the administration of the composition and reorganization provisions of the Act" (p. 141, *ibid.*)—and did so in order (a) to interpret the meaning of Section 83(b), 11 U. S. C. A. 403(b), providing that the judge "may allow reasonable compensation" for services rendered and (b) to decide whether an acceptance of the plan by the claimant was "in good faith" within the correct meaning of Section 83(e)(5), 11 U. S. C. A. 403(e)(5). Again, the answer to both questions and the proper construction of both sections were found in basic principles drawn from the law of trusts: thus the Court said that "reasonable compensation" for services rendered necessarily implies "loyal and disinterested service" (p. 147 of 311 U. S.) and concluded that because of claimant's conflicting and undisclosed interests, the compensation was unreasonable and its acceptance of the plan not in good faith.

Both the foregoing decisions illustrate vividly the intimate relation between doctrines of equity and the practical application of the Bankruptcy Act. Nor is this union strange since, as this Court has said:

> "A bankruptcy court is a court of equity, § 2, 11 U. S. C., § 11, and is guided by equitable doctrines and principles except in so far as they are inconsistent with the Act * * *." *Securities and Exchange Commission v. United States Realty & Improvement Co.*, 310 U. S. 434, 455, cited in *American United Mutual Life Insurance Co. v. City of Avon Park, Florida, supra*, at p. 145; and *Pepper v. Litton*, 308 U. S. 295, 304 *et seq.*

(b) The Other Briefs in Opposition. The Van Sweringen Company asserts that although the question here arises in reorganization proceedings, "that is only incidental and accidental," and that this case does not involve "questions in the administration or interpretation of the Bankruptcy Act." (p. 10 of The Van Sweringen Com-

pany brief.) This adds nothing to what is said by Van Sweringen Corporation, and Midamerica believes that this position is demonstrably unsound in light of the reasons for granting certiorari in *Woods, Court Trustee, v. City National Bank and Trust Co. of Chicago, et al.* and *American United Mutual Life Insurance Co. v. City of Avon Park, Florida, supra,* and in light of the blended questions of fiduciary law and bankruptcy law presented by those two cases.

The Cleveland Terminals Building Company (hereinafter called "C. T. B.") makes no attempt whatever to meet Midamerica's contention on this score; and A. B. Gochenour, *et al.*, intervenors, content themselves with the observation that the petitioner's argument is "designed to create 'confusion' in rules which are plain and clear." (p. 8, Gochenour brief in this case, No. 613.)*

2. In Federal Corporate Reorganization Proceedings the Criteria for Allowing or Disallowing Claims of Fiduciaries Should Not Depend on the Particular Jurisdiction Involved.

The field of corporate reorganizations is not an area where conflict among the circuits should be permitted to exist as "merely corollary to a permissible difference of opinion in the state courts." See *Ruhlin v. New York Life*

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* Midamerica naturally does not suggest that every disallowance of a claim in an ordinary case should be reviewed by this Court. The present, however, is emphatically not an ordinary case. It confuses the law of fiduciaries by applying the rule of *Pepper v. Litton, supra,* to a case where *Twin-Lick Oil Co. v. Marbury,* 91 U. S. 587 (1890) and *Sanford Fork & Tool Co. v. Howe, Brown & Company,* 157 U. S. 312 (1895) point the applicable doctrine. It penalizes directors "who have prevented a suspension of the business and enabled the corporation to continue its operations" (contrary to the *Sanford* case, pp. 316, 317). It casts a cloud on many titles to claims bought by officers and directors. And finally, although the present is a striking case, it is only one example of typical and expanding litigation on this subject in corporate reorganizations.

Insurance Co., 304 U. S. 202, 206 (1938). The Bankruptcy Act is a national statute which "was intended for business men and should receive not only a practical, but a uniform construction." *Kreitlein v. Ferger*, 238 U. S. 21, 30 (1915).

Thus, the test of whether a plan under former Section 77B or under Chapter X is "fair and equitable" has been determined for all the circuits by this Court in *Case et al., v. Los Angeles Lumber Products Co., Limited*, 308 U. S. 106 (1939). Similarly, the rules laid down in the *Woods* and *City of Avon Park* cases, *supra*, are the law of the land applicable in all Chapter X and Chapter IX proceedings, respectively. Midamerica believes that by analogy and in the evident interest of uniformity under the Act this principle should govern here, and the briefs in opposition do not seriously challenge this position, but argue mainly that no conflict or divergence in fact exists.

(a) The discretion of this Court in granting a writ should not be affected by counsel's failure to cite a conflicting Circuit Court of Appeals decision to support a position for which decisions of this Court were cited.

The Debtor contends that the failure of petitioner in the court below to rely specifically on *In re New York Railways Corporation*, 82 F. (2d) 739 (C. C. A. 2, 1936) precludes it from urging any conflict with this decision now.*

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* The Debtor makes the same contention with respect to *Arn v. Bradshaw Oil & Gas Co.*, 108 F. (2d) 125 (C. C. A. 5, 1940), cert. den., 310 U. S. 646. Midamerica did not cite the *Arn* case in its petition as being in the same category with *In re New York Railways Corporation* or as establishing a square conflict among the circuits (see pp. 24-25 of Midamerica's brief in support of its petition), but rather as a recent interpretation and application of *Twin-Lick Oil Co. v. Marbury*, 91 U. S. 587 (1875), and as therefore embodying the applicable doctrine to be followed in this case. Nothing said by the Debtor disturbs this conclusion. (See pp. 24-25 of Midamerica's brief.)

The jurisdiction of this Court to grant certiorari based on conflict among the circuits is, of course, not affected, nor is the discretion of this Court measured, by counsel's choice of authorities in the lower court; and petitioner's failure to cite a particular case in support of a position amply supported by other authorities is in no way analogous, as the Debtor claims, to raising for the first time in this Court a question not raised below. If this were true, no new authority could ever be cited here. Moreover, Midamerica did cite, and heavily relied upon, the two decisions of this Court whose facts make their holdings relevant to the case at bar, and whose philosophy of allowing fiduciaries to protect legitimately acquired interests is the foundation of *In re New York Railways Corporation*: i.e., *Twin-Lick Oil Co. v. Marbury* and *Sanford Fork & Tool Co. v. Howe, Brown & Company, both supra.* These decisions clearly announce the equitable doctrine which should be applied in favor of director-guarantors and which the decision below ignored.

(b) In re New York Railways Corporation is in conflict with the decision below.

The reason for Midamerica's failure to cite *In re New York Railways Corporation* below was simply that it had not then searched the record of that case and, therefore, had not then realized the narrowly restricted sense in which the Court of Appeals for the Second Circuit was using the word "independence" when it talked of the "independence" of the board of the wholly owned subsidiary railway. The case, however, is evidently in conflict.

(i) *The Railway was no more independent than this Debtor.*

This search disclosed that the "independence" consisted solely of the fact that although the parent (the Fifth Avenue Coach Company) at all material times owned 100%

of the subsidiary railway's voting stock, a change in the personnel of the railway's board—evidently engineered by the parent and accomplished by resignations of some of the subsidiary's directors—reduced the number of the parent's own directors, employees, and associates on the subsidiary's board from a majority to a minority. There is no other record evidence of "independence" or lack of control, by the parent, of its subsidiary.

Control is not a metaphysical, but a practical concept, and it may be exercised in various ways. As this Court said in *Southern Pacific Co. v. Bogert*, 250 U. S. 483, 492, in disposing of a contention that control was only indirectly exercised:

> "* * * But the doctrine by which the holders of a majority of the stock of a corporation who dominate its affairs are held to act as trustees for the minority, does not rest upon such technical distinctions. It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation."

We are here concerned with important rights, and the issue should not be decided by words or labels, but by the fundamental facts and relationships involved.

(ii) *The Railway was insolvent and no more able to buy its Bonds than was this Debtor.*

Unless the *New York Railways* case can be distinguished upon the ground of control, it is not distinguishable at all. This is apparent from the illuminating circumstance that three of the five briefs filed in opposition to Midamerica's petitions (those filed by C. T. B. in Case No. 614, and by Gochenour, *et al.*, intervenors, in Case No. 613 and Case No. 614), do not even attempt to distinguish the *New York Railways* case upon any other ground, and likewise from the evident weakness of the Debtor's two other principal grounds of difference.

Thus the Debtor asserts that "nowhere does it appear that the debtor [the New York Railway] was insolvent at the date its bonds were purchased" (p. 14 of Van Sweringen Corporation brief). But it does appear "that there was no equity in the stock," that the railway "fell behind about a million dollars yearly," and that it was "contemplating reorganization" (p. 741 of the opinion in 82 F. (2d)).

Finally, it is urged that "the debtor was financially unable to buy up its bonds" (p. 14 of Van Sweringen Corporation brief). True, but so was this Debtor, Van Sweringen Corporation. It was admittedly insolvent and had only $13.67 in cash on hand to buy notes which aggregated $13,787,000 in principal amount and which even on the Debtor's own theory cost $887.

The finding of the district court, impliedly approved by the court below, that the Debtor was financially able to buy its notes, is a mere inference wholly unjustified by the only evidence in the record. *The record shows that, apart from the trifling sum of $13.67 on hand, the Debtor had literally no assets whatever except an unsecured claim against its subsidiary, C. T. B., which then had a deficit of more than $29,000,000* (R. 97-99) *and which is not shown either to have paid, or been legally able to pay, one dollar to the Debtor on September 30, 1935, the day of the Morgan auction sale* (R. 33).

Furthermore, as C. T. B. admits in its brief (p. 8), the New York court declared, as an alternative ground of its holding, that "no matter how able the debtor was to buy the income bonds for itself" (page 742 of 82 F. (2d)), its inaction was not owing to the parent's control. We have seen above that "control" is not a valid differentiation between the two cases and that a dominant stockholder, like a director, is a fiduciary. Consequently, even if Van Sweringen Corporation had been able to buy its notes for itself, the cases would still be parallel.

3. Conclusion.

Midamerica respectfully submits: (a) that the conflict between the decision below and *In re New York Railways Corporation* concerns a question of substantial importance both in the law of fiduciaries and in the uniform administration of the Bankruptcy Act; (b) that the decision below fails to follow controlling decisions of this Court, *Twin-Lick Oil Co. v. Marbury* (as recently interpreted and applied in *Arn v. Bradshaw Oil & Gas Co.*), and *Sanford Fork & Tool Co. v. Howe, Brown & Company*; (c) that this Court's discretion should not be affected by whether the *New York Railways* case and the *Arn* case were cited below; (d) that, whether or not the decision below is sound (which Midamerica, of course, strenuously denies), the mixed questions of fiduciary law and of bankruptcy law here presented are each genuinely important in their own right, and both make advisable an authoritative ruling by this Court.

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